

STATE OF MICHIGAN
DEPARTMENT OF NATURAL RESOURCES AND ENVIRONMENT

ORDER OF THE SUPERVISOR OF WELLS

IN THE MATTER OF

THE PETITION OF WELLMASTER EXPLORATION &)
PRODUCTION CO., LLC FOR AN ORDER FROM THE)
SUPERVISOR OF WELLS ESTABLISHING A 640-ACRE)
PRAIRIE DU CHIEN GROUP DRILLING UNIT CONSISTENT) ORDER NO. 14-2010
WITH SPECIAL ORDER NO. 1-86 BY COMPULSORY)
POOLING ALL INTERESTS INTO THE UNIT CONSISTING)
OF PART OF MECOSTA TOWNSHIP, MECOSTA COUNTY,)
MICHIGAN.

OPINION AND ORDER

This case involves the Petition of Wellmaster Exploration & Production Co., LLC (Petitioner). The Petitioner has drilled and completed a well for oil and gas exploration (the State Mecosta & Alber 1-23A well, Permit Number 60002) within a drilling unit in the stratigraphic intervals known as the Glenwood Formation and/or Prairie du Chien Group. Under Special Order No. 1-86, the drilling unit size for a Prairie du Chien Group well is 640 acres, more or less. Since not all of the mineral owners within the proposed drilling unit have agreed to voluntarily pool their interests, the Petitioner seeks an Order of the Supervisor of Wells (Supervisor) designating the Petitioner as operator of a drilling unit consisting of four contiguous governmental surveyed quarter sections and requiring compulsory pooling of all tracts and interests within that geographic area for which the owners have not agreed to voluntary pooling.

Jurisdiction

The development of oil and gas in this State is regulated under Part 615, Supervisor of Wells, of the Natural Resources and Environmental Protection Act, 1994 PA 451, as amended (NREPA). MCL 324.61501 *et seq.* The purpose of Part 615 is to ensure the orderly development and production of the oil and gas resources of this State. MCL 324.61502. To that end, the Supervisor may establish drilling units and

compulsorily pool mineral interests within said units. MCL 324.61513(2) and (4). However, the formation of drilling units by compulsory pooling of interests can only be effectuated after an evidentiary hearing. 1996 MR 9, R 324.302 and R 324.304. The evidentiary hearing is governed by the applicable provisions of the Administrative Procedures Act, 1969 PA 306, as amended, MCL 24.201 *et seq.* See 1996 MR 9, R 324.1203. The evidentiary hearing in this matter was held on October 19, 2010.

FINDINGS OF FACT

Petitioner specifically requests that the Supervisor issue an Order that:

1. Requires compulsory pooling of all tracts and mineral interests within the proposed drilling unit that have not agreed to voluntary pooling;
2. Names Petitioner as operator of the proposed drilling unit and the State Mecosta & Alber 1-23A well; and
3. Authorizes Petitioner to recover certain costs from the parties subject to the compulsory pooling order.

The Administrative Law Judge determined the Notice of Hearing was properly served and published. No answers to the Petition were received. The Supervisor designated the hearing to be an evidentiary hearing pursuant to R 324.1205(1)(c) and directed evidence be presented in the form of verified statements.

In support of its Petition, the Petitioner offered the verified statements of Craig D. Close, Contract Landman for Petitioner, and Charles Sternbach, Petroleum Geologist.

I. Drilling Unit

The spacing of wells targeting the Glenwood Formation/Prairie du Chien Group is governed by Special Order No. 1-86. This Order establishes drilling units of 640 acres, more or less, consisting of four contiguous governmental-surveyed quarter sections of land in a square, with allowances being made for the size and shape of the government-surveyed quarter sections. The Petitioner's proposed drilling unit is described as all of Section 23, T14N, R10W, Mecosta Township, Mecosta County, Michigan.

I find that the drilling unit, as proposed in the Petition, is consistent with Special Order No. 1-86; and, as such, it is a proper drilling unit for the proposed well.

II. Drilling Unit Operator

Mr. Close states Petitioner owns or controls all but 1.0 net acres of mineral interests.

The Petitioner seeks to be designated as the operator of the drilling unit for the State Mecosta & Alber 1-23A well. I find, as a Matter of Fact, the Petitioner is eligible to be designated operator of the State Mecosta & Alber 1-23A well.

III. Compulsory Pooling

As found, the Petitioner has proposed a proper drilling unit for the Glenwood Formation/Prairie du Chien Group but was unable to obtain the agreement of all mineral and working interest owners to gain its full control of the interests in such unit. The Petitioner may not produce a well on the drilling unit without first obtaining control of all of the oil and gas interests. In cases like this, it is necessary for the Petitioner to request compulsory pooling from the Supervisor. As discussed, a mineral or working interest owner who does not agree to voluntarily pool his, her, or its interest in a drilling unit may be subject to compulsory pooling. 1996 MR 9, R 324.304. The compulsory pooling of an interest must be effectuated in a manner that ensures "each owner...is afforded the opportunity to receive his or her just and equitable share of the production of the unit." Id. In addition to protecting correlative rights, the compulsory pooling must prevent waste. MCL 324.61502. An operator must first seek voluntary pooling of mineral interests within a proposed drilling unit prior to obtaining compulsory pooling through an order of the Supervisor.

All of the owners of oil and gas interests within the proposed drilling unit agreed to voluntarily pool their interests, with the exception of the following 1.0 net acre of undivided private mineral rights:

<u>Name</u>	<u>Description</u>	<u>Gross Acres</u>	<u>Net Acres</u>
Garnett Production Partners, LP	E 1/2 of SW 1/4, Sec. 23	80	0.65
Garnett Royalty Partners 1991, LP	E 1/2 of SW 1/4, Sec. 23	80	0.35
Total Unleased Acreage			1.00

Mr. Close's verified statement indicates Petitioner made numerous attempts to lease the mineral interest owners who had not yet voluntarily pooled their interests for the purposes of producing the State Mecosta & Alber 1-23A well.

Based on the foregoing, I find, as a Matter of Fact:

1. The Petitioner was able to voluntarily pool all but approximately 1.0 net undivided mineral acre of the proposed 640-acre Glenwood Formation/Prairie du Chien Group drilling unit.
2. Compulsory pooling is necessary to form a full drilling unit, to protect correlative rights of unleased mineral owners, and to prevent waste by preventing the drilling of unnecessary wells.

Now that it has been determined compulsory pooling is necessary and proper in this case, the terms of such pooling must be addressed. When pooling is ordered, the owner of the compulsorily pooled lands or interests (Pooled Owner) is provided an election on how he or she wishes to share in the costs of the project. R 324.1206(4). A Pooled Owner may participate in the project, or in the alternative be "carried" by the operator. If the Pooled Owner elects to participate, he or she assumes the economic risks of the project, specifically, by paying his or her proportionate share of the costs or giving bond for the payment. Whether the well drilled is ultimately a producer or dry hole is immaterial to this obligation. Conversely, if a Pooled Owner elects not to participate, the Pooled Owner is, from an economic perspective, "carried" by the operator.

In order for a Pooled Owner to decide whether he or she will "participate" in the well or be "carried" by the operator, it is necessary to provide reliable cost estimates. In this regard the Petitioner must present proofs on the estimated costs involved in drilling, completing, and equipping the proposed well. Petitioner's Authorization for Expenditure (AFE) form for the State Mecosta & Alber 1-23A well itemizes estimated and actual costs to be incurred or already incurred in the drilling, completing, equipping, and plugging of the well (Exhibit B to Mr. Sternbach's verified statement). The costs are \$1,922,106.77 for drilling (actual); \$288,473.17 for completion (actual); and

\$1,532,000.00 for equipping (estimated). The total producing well costs, to date, for the State Mecosta & Alber 1-23A well is \$3,742,579.94. Id.

There is no evidence on this record refuting Petitioner's costs. However, I find that leasing costs (\$80,000) should not be included in drilling costs to be shared with the Pooled Owner. I find, as a Matter of Fact, the remaining costs are reasonable for the purpose of providing the pooled owners a basis on which to elect to participate or be carried. I find final actual costs shall be used in determining the final share of costs and additional compensation assessed against a Pooled Owner.

The next issue is the allocation of these costs. Part 615 requires the allocation be just and equitable. MCL 324.61513(4). Mr. Sternbach states, based on his review, study and analysis of all available engineering and geological information, Petitioner has ascertained the possibility of the existence of a productive Prairie du Chien Group Formation beneath the 640-acre drilling unit. The Petitioner requests the actual well costs and production from the well be allocated on a surface acreage basis. Established practices and industry standards suggest allocation based upon the ratio of the number of net mineral acres in the tracts of various owners to the total number of net mineral acres in the drilling unit to be a fair and equitable method of allocation of production and costs. Therefore, I find, as a Matter of Fact, utilizing net mineral acreage is a fair and equitable method to allocate to the various tracts in the proposed drilling unit each tract's just and equitable share of unit production and costs.

Petitioner has completed the drilling, completion, and equipping operations on the State Mecosta & Alber 1-23A well and is not requesting additional compensation for the risk of a dry hole. Petitioner requests, in the event the unleased owners do not elect to participate, that the Operator be allowed to take out of the non-participating party's share of production, said party's share of the actual cost of drilling, completing, and equipping the well, plus the nonparticipating party's share of actual operating costs.

CONCLUSIONS OF LAW

Based on the findings of fact, I conclude, as a matter of law:

1. The Supervisor may compulsorily pool properties when pooling cannot be agreed upon. Compulsory pooling is necessary to prevent waste and protect the correlative rights of the Pooled Owners in the proposed drilling unit. MCL 324.61513(4).
2. This Order is necessary to provide for conditions under which each mineral and working interest owner who has not voluntarily agreed to pool all of his, her, or its interest in the pooled unit may share in the production. 1996 AACRS, R 324.1206(4).
3. The Petitioner is an owner within the drilling unit and, therefore, is eligible to operate the State Mecosta & Alber 1-23A well. 1996 AACRS, R 324.1206(4).
4. The Petitioner is authorized to take from each nonparticipating interest's share of production, the cost of drilling, completing, equipping, and operating the well. 1996 AACRS, R 324.1206(4).
5. The applicable spacing for the proposed drilling unit is 640 acres, more or less, as established by Special Order No. 1-86.
6. The Supervisor has jurisdiction over the subject matter and the persons interested therein.
7. Due notice of the time, place, and purpose of the hearing was given as required by law and all interested persons were afforded an opportunity to be heard. 1996 AACRS, R 324.1204.

DETERMINATION AND ORDER

Based on the Findings of Fact and Conclusions of Law, the Supervisor determines that compulsory pooling to form a 640-acre Glenwood Formation/Prairie

du Chien Group drilling unit is necessary to protect correlative rights and prevent waste by the drilling of unnecessary wells.

NOW, THEREFORE, IT IS ORDERED:

1. A 640-acre Glenwood Formation/Prairie du Chien Group drilling unit is established for the following area: all of Section 23, T14N, R10E, Mecosta Township, Mecosta County, Michigan. All properties, parts of properties, and interests in this area are pooled into the drilling unit. This pooling is for the purpose of forming a drilling unit only and neither establishes a right, nor diminishes any independent right, of the Petitioner to operate on the surface or subsurface lands of a Pooled Owner.
2. Each Pooled Owner shall share in production and costs in the proportion that their net mineral acreage in the drilling unit bears to the total acreage in the drilling unit.
3. The Petitioner is named Operator of the drilling unit for the State Mecosta & Alber 1-23A well. This pooling Order applies to the State Mecosta & Alber 1-23A well only.
4. A Pooled Owner who is an unleased mineral owner shall be treated as a working interest owner to the extent of 100 percent of the interest owned in the drilling unit. Such a Pooled Owner is considered to hold a 1/8 royalty interest, which shall be free of any charge for the costs of drilling, completing, or equipping the well, or for compensation for the risks of the well, or operating the proposed well.
5. A Pooled Owner shall have ten days from the effective date of this Order to select one of the following alternatives and advise the Supervisor and the Petitioner, in writing, accordingly:

a. To participate, by paying to the Operator, within ten days of making the election, the Pooled Owner's share of the actual costs for drilling and completing the well, and estimated costs for equipping the well, or by giving bond for the payment of the Pooled Owner's share of such costs within 10 days of the effective date of this order; and authorizing the Operator to take from the remaining 7/8 of such Pooled Owner's share of production, the Pooled Owner's share of the actual costs of operating the well; or

b. To be carried, then if the well is put on production, authorize the Operator to take from the remaining 7/8 of the Pooled Owner's share of production:

(i) The Pooled Owner's share of the actual cost of drilling, completing, and equipping the well.

(ii) The Pooled Owner's share of the actual cost of operating the well.


6. In the event the Pooled Owner does not notify the Supervisor in writing of the decision within ten days from the effective date of this Order, the Pooled Owner will be deemed to have elected the alternative described in ¶ 5(b). If a Pooled Owner who elects the alternative in ¶ 5(a) does not, within ten days of making their election, pay their proportionate share of costs or give bond for the payment of such share of such costs, the Pooled Owner shall be deemed to have elected the alternative described in ¶ 5(b) and the Operator may proceed to withhold and allocate proceeds for costs from the Pooled Owners' share of production (the remaining 7/8 in the case of an unleased mineral owner) as described in 5(b)(i)&(ii).

7. For purposes of the Pooled Owners electing alternatives, the amounts of \$1,842,106.77 for drilling costs; \$288,473.17 for completion costs; and

\$1,532,000.00 for estimated equipping costs are fixed as well costs. Final actual costs shall be used in determining the Pooled Owner's final share of well costs. If a Pooled Owner has elected the alternative in ¶ 5(a) and the actual cost exceeds the estimated cost, the Operator may recover the additional cost from the Pooled Owner's share of production (the remaining 7/8 in the case of an unleased mineral owner). Within 30 days of the effective date of this Order, and every 30 days thereafter until all costs of drilling, completing, and equipping the well are accounted for, the Operator shall provide to the Pooled Owner a detailed statement of actual costs incurred as of the date of the statement; and all costs and production proceeds allocated to that Pooled Owner.

8. All Pooled Owners shall receive the following information from the Operator by no later than the effective date of the Order:
 - a. The Order;
 - b. The AFE; and
 - c. Each Pooled Owner's percent of charges from the AFE if the Pooled Owner were to choose option "a" in Paragraph 5, above.
9. A Pooled Owner shall remain a Pooled Owner only until such time as a lease or operating agreement is entered into with the Operator. At that time, terms of the lease or operating agreement shall prevail over the terms of this Order.
10. The Supervisor retains jurisdiction in this matter.
11. The effective date of this Order is Jan. 14, 2011.

DATED: Jan. 4, 2011


HAROLD R. FITCH
ASSISTANT SUPERVISOR OF WELLS
Office of Geological Survey
P.O. Box 30256
Lansing, MI 48909